APPENDIX M

Analysis of the Fair Claims Settlement Practices Act

COMMISSION ON HEALTH AND SAFETY AND WORKERS' COMPENSATION

MEMORANDUM

Date: June 8, 1998

To: Christine Baker, Executive Officer

From: C. L. Swezey, Consultant

Re: Application of Fair Claims Settlement Practices Act [Insurance Code §790.03(h)] to Workers' Compensation

Insurance Code §§790-790.10 were enacted to define, prohibit, and provide penalties for unfair methods of competition and deceptive practices in the insurance industry. Section 790.01 makes the act applicable to specified types of insurers and agents "as well as all other persons engaged in the business of insurance." Section 790.03 lists eight kinds of prohibited acts and practices some of which are applicable only to life insurance. Subsection (h) forbids "knowingly committing *or* performing with such frequency as to indicate a general business practice" 16 specified unfair claims settlement practices ." [Emphasis added.] Section 790.04 says that the commissioner shall have the power to investigate "every person engaged in the business of insurance" in California to determine if that person has engaged in any practice prohibited by §790.03.

Pursuant to §790.035, the insurance commissioner adopted regulations in 10 Cal Code Regs §§2695.1-2695.14 to administer and enforce §790.03(h). Section 2695.1(b)(1) of the regulations excludes the handling and settlement of claims under workers' compensation insurance. Section 2695.1(d) repeats that the regulations shall not apply to the handling or settlement of claims brought under workers' compensation insurance policies.

Thus, it appears that although Insurance Code §§790-790.10 are broad enough to define unfair practices by workers' compensation insurance carriers, the insurance commissioner has declined to assert authority over them. The position of the commissioner is understandable. It has been judicially well settled that unfair claims practices by workers' compensation insurers are, with one exception, within the exclusive jurisdiction of the WCAB. The Legislature has, moreover, now given the Administrative Director of DWC the authority to audit these insurers and assess penalties for failure to meet their obligations under the Labor Code.

Recognition of the jurisdiction of the WCAB over unfair claims practices has evolved in bad faith civil actions against workers' compensation insurance carriers. When within their proper role, these insurers are considered to be the alter ego of the employer and protected by the exclusive remedy rule and immune from civil damages liability to injured employees. There is an exception if an insurer embarks on a deceitful course of conduct that causes injury to an injured employee. In that instance it has gone outside its proper role as an insurer and may be liable for damages. This exception was established in 1972 in *Unruh v. Truck Ins. Exch.*, but most subsequent attempts to come under the exception and sue for bad faith in Superior Court have been unsuccessful because the conduct alleged was not sufficiently outrageous to be outside the role of the insurer.. The WCAB penalizes unfair claims practices by awarding increases in benefits under Labor Code §5814 which can be very substantial.

The following claims practices have been held by appellate courts to be within the exclusive jurisdiction of the WCAB: failure to pay even though alleged to be fraudulent and malicious; seeking to persuade a worker to take less than the award to avoid an appeal; ignoring WCAB subpoenas; refusal to pay an indisputably valid claim; failure to pay a stipulated award; failure to inform worker of availability of VR; and refusal to authorize surgery. On the other hand, a civil action was allowed for fraudulently denying coverage

and destroying evidence. In 1995, a civil action alleging destruction of medical reports and forging of substitutes was settled for a substantial sum after a Superior Court overruled a demurrer to the complaint.

Labor Code §§129 and 129.5 give the Administrative Director of the Division of Workers' Compensation authority to audit and penalize insurers for unfair claims practices with civil penalties up to $100,000. The $100,000 penalty can be assessed if the AD finds that an insurer "has knowingly committed *and* has performed with a frequency as to indicate a general business practice" one of four specified serious unfair claims practices. [Emphasis added.] These sections, however, expressly recognize the authority of the insurance commissioner over workers' compensation insurers. Section 129 says that nothing therein shall restrict the authority of the insurance commissioner to audit his or her licensees; and §129.5(d) mandates the AD to refer a second finding that an insurer has knowingly engaged in a general business practice of unfair claims adjustment to the insurance commissioner to determine if the insurer's certificate of authority should be revoked.

We have been informed by Joel Laucher, Chief of the DOI Consumer Services Division, that he believes that DOI has the authority to pursue workers' insurance carriers for unfair practices. This is certainly true with respect to license suspension and revocation, and the insurance commissioner could probably extract fines as a condition for probation in lieu of revocation or suspension. Attempts by DOI to assess penalties that the WCAB or the AD could impose could possibly be challenged on exclusive remedy grounds. As a practical matter, moreover, except for revoking or suspending licenses, the WCAB and DWC Audit probably have more effective tools for dealing with unfair claims practices. DOI does, have two practical tools which DWC lacks, i.e., (1) a more liberal statutory authority for major penalties, and (2) an effective complaint processing mechanism.

As indicated above DOI can assess penalties for an unfair claims settlement practice if the commissioner finds that it was *either* knowingly committed *or* was done with such frequency as to indicate a general business practice. The AD, on the other hand, must prove both before he can assess a penalties in excess of $5,000 per violation.

Currently, complaints received by DWC Audit are used only for the purpose of targeting audits and are not uniformly investigated. This is apparently not generally understood in the workers' compensation community and may be the impetus for whatever agitation there is for DOI to take jurisdiction over workers' compensation insurance claims practices.

The first DWC drawback can be remedied by amending Labor Code §129.5(d) to put the required findings in the disjunctive as they are in Insurance Code §790.03(h) if this is what the Legislature intended. The second can be corrected administratively by DWC's developing complaint processing procedures in the Information and Assistance and Audit Units.